ALTS
ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES

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April 17, 2000

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Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: 1998 Biennial Regulatory Review—Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket No. 98-137; Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, *et. al.*, CC Docket No. 99-117; GTE Telephone Operating Companies Release of Information Obtained During Joint Audit, AAD File No. 98-26

Dear Ms. Salas:

Please find attached an original and eight copies of the Comments of the Association for Local Telecommunications Services ("ALTS") with regard to the Commission's Further Notice of Proposed Rulemaking in the above-referenced proceeding.

Sincerely,

Teresa K. Gaugler

cc: ITS, Inc. (paper and diskette copies)
Debbie Byrd, Accounting Safeguards Division (diskette only)

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
	)	
1998 Biennial Regulatory Review— Review of Depreciation Requirements for Incumbent Local Exchange Carriers	)	CC Docket No. 98-137
	)	
Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, *et. al.*	)	CC Docket No. 99-117
	)	
GTE Telephone Operating Companies Release of Information Obtained During Joint Audit	)	AAD File No. 98-26

COMMENTS OF
THE ASSOCIATION FOR LOCAL TELECOMMUNCATIONS SERVICES

As part of its biennial review of depreciation requirements, the Commission recently adopted procedures specifying how price cap incumbent local exchange carriers ("ILECs") may obtain a waiver from the Commission's depreciation requirements.[1] In a March 3, 2000 *ex parte* letter, the ILEC members of the Coalition for Affordable Local and Long Distance Services ("CALLS ILECs") proposed an alternative waiver proposal.[2] The Association for Local Telecommunications Services ("ALTS") hereby files it comments on the Notice of Proposed

[1] *See* 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, *Report and Order*, CC Docket No. 98-137, FCC 99-397 (rel. Dec. 30, 1999) ("*Depreciation Order*").
[2] *See* March 3, 2000 *ex parte* letter to Mr. Lawrence Strickling, Chief, Common Carrier Bureau from Frank J. Gumper, Bell Atlantic Network Services, Robert Blau, BellSouth Corporation, Donald E. Cain, SBC Telecommunications, Inc. and Alan F. Ciamporcero, GTE Service Corporation in CC Docket No. 96-262 – Access Charge Reform; CC Docket No. 94-1 – Price Cap Performance Review for Local Exchange Carriers; CC Docket No. 99-249 – Low-Volume Long Distance Users; and CC Docket No. 96-45 – Federal-State Joint Board on Universal Service ("*Ex Parte Letter*").

Rulemaking issued by the Commission to evaluate the CALLS ILEC depreciation waiver proposal as it would apply to all price-cap carriers.[3]

I. INTRODUCTION AND SUMMARY

In its *Depreciation Order*, the Commission adopted a package of depreciation policy reforms and provided the opportunity for price cap ILECs to obtain a waiver from the Commission's depreciation prescription process.[4] The Commission specified under what conditions it would be appropriate to grant a waiver, emphasizing that these conditions were necessary to avoid any harmful effects that unrestricted changes in depreciation could have on consumers and competition.[5] ALTS demonstrates below that the changes to the waiver process as proposed by the CALLS ILECs may create precisely the harmful impacts that the Commission sought to avoid in developing its waiver conditions.

In their *ex parte* letter, the CALLS ILECs propose substantial revisions to the Commission waiver approach.[6] While their proposal would retain the benefits of reduced regulatory oversight for the participating ILECs, it would eliminate the key protections to consumers and the competitive market that were established by the Commission. Specifically, while it appears that the CALLS ILEC proposal will not affect the level of interstate retail charges to ratepayers, it may result in higher intrastate retail charges than would otherwise be the case, and ultimately in significantly higher unbundled network elements ("UNEs") and interconnection charges.

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[3] *See* 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, *Further Notice of Proposed Rulemaking*, CC Docket No. 98-137, (rel. April 3, 2000) ("*Depreciation NPRM*").
[4] *See Depreciation Order* ¶¶ 24-35.
[5] *Id.*

II. THE CALLS ILEC WAIVER PROPOSAL MAY LEAD TO HIGHER INTRASTATE RETAIL RATES UNLESS THE COMMISSION ENSURES THAT THE ILECS COMMIT TO FORGO RECOVERY OF THE INTRASTATE PORTION OF THE AMORTIZATION EXPENSE.

In its *Depreciation Order*, the Commission determined that a waiver of its depreciation prescription process may be approved if an ILEC voluntarily

> "(1) adjusts the net book costs on its regulatory books to the level currently reflected in its financial books by a below-the-line write-off; (2) uses the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) foregoes the opportunity to seek recovery of the write-off through a low-end adjustment, and exogenous adjustment; or and above-cap filing; and (4) agrees to submit information concerning its depreciation accounts, including forecast additions and retirements for major network accounts and replacement plans for digital central offices."[7]

The Commission stressed that it would accept alternative proposals only if they provide "the same protections to guard against adverse impacts on consumers and competition as the conditions adopted in [the *Depreciation Order*] provide."[8] ALTS maintains that the CALLS ILEC proposal does not provide the same protections as the Commission's conditions; therefore, the Commission should not accept the proposal.

The CALLS ILEC proposal is consistent with the Commission's condition that the ILEC use the same set of depreciation factors and rates for both financial and regulatory accounting purposes. Furthermore, similar to the Commission's conditions, the CALLS ILEC proposal contemplates eliminating the disparity in depreciation reserves between the participating ILECs' financial and regulatory books. However, the path to that goal is substantially different from that contemplated by the Commission's waiver plan.

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[6] *See Ex Parte Letter.*
[7] *Depreciation Order* ¶ 25.
[8] *Id.*

Using a single set of depreciation factors for regulatory and financial purposes as contemplated by both plans would create a depreciation reserve deficiency. Through the Commission's plan, the depreciation reserve deficiency would be offset by a below-the-line write-off taken immediately and directly.[9] A waiver under these conditions would result in higher depreciation rates and, with this write-off, a smaller rate base. The Commission suggests that the revenue requirement and earnings effects of higher depreciation rates are almost exactly offset by the effect of a reduced rate base.[10] Thus, with the write-off taken below-the-line, per the Commission's plan, there would be no material impact on regulatory earnings or revenue requirements, and no changes necessary in retail rates. On the contrary, the CALLS ILECs propose to leave the depreciation reserve deficiency above-the-line and amortize it over five years. Such treatment would cause a decrease in regulatory earnings and an increase in the associated revenue requirements. Thus, regulated earnings under the CALLS ILEC proposal would be lower than under the Commission's plan, allowing the ILEC the opportunity to seek recovery of the write-off.

The Commission's plan requires that any ILEC seeking a waiver from depreciation requirements commit to forgo the opportunity to seek recovery of the write-off. While this requirement applies only to interstate rates, the Commission acknowledges that as a general practice, states tend to follow the Commission's depreciation policy; therefore, treatment and recovery of this write-off under the Commission's rules would likely impact intrastate rates.[11] Thus, if the Commission requires the write-off to be taken below-the-line for interstate

[9]As the FCC recognized, the dollar value of assets that constitute this depreciation reserve deficiency do not exist on the ILECs' financial books. With the higher depreciation rates used for financial reporting purposes, these assets have already been written off. Thus, the FCC proposal will have no impact on the ILECs' financial books. *Depreciation Order* ¶ 26.

[10] *Depreciation NPRM* ¶ 5.

regulatory purposes, the same would likely apply in most states for intrastate regulatory purposes. Only by requiring the write-off to be taken below-the-line will the Commission ensure there is no earnings or revenue requirement impact on interstate or intrastate operations. In other words, the Commission's waiver plan ensures that consumers of interstate and intrastate retail services are free of any requirement to compensate the ILEC for adopting the financial depreciation policy for regulatory purposes.

The CALLS ILECs merely commit to forgo the opportunity to seek recovery of the interstate, not the intrastate, portion of the resulting amortization expense, both in the interstate or the intrastate jurisdictions:[12] "the ILECs will commit not to seek recovery of the interstate amortization expense through any rate action at the state level, including any action on UNE rates."[13] By limiting the nonrecovery commitment to the interstate portion, there is no mechanism to prevent the ILECs from seeking recovery of the intrastate portion of the amortization expense through higher intrastate rates. The Regional Bell Operating Companies ("RBOCs") remain subject to rate of return regulation in several states, and independent LECs are subject to rate of return regulation in many more states. Thus, increasing intrastate rates to recover a significant portion of the reserve deficiency would be entirely possible if the amortization were above-the-line. The Commission suggests that the CALLS ILECs intend to forgo recovery, at the state level, of any portion of the amortization,[14] and ALTS urges the Commission to obtain such a clear commitment from the participating ILECs before a waiver would be granted. Moreover, even if no rate increase were proposed or if rate increases were

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[11] *Depreciation NPRM* ¶ 8.
[12] *See Ex Parte Letter*.
[13] *Id.* (emphasis added).
[14] *Depreciation NPRM* ¶ 10 n.25.

restricted, the reduced level of regulatory earnings and the associated increased revenue requirements may limit the number and/or magnitude of rate reductions that would otherwise occur. Thus, the Commission should not dismiss the possibility that intrastate rates will on average be higher if the write-off is permitted above-the-line, as the CALLS ILECs propose.

III. USE OF HIGHER FINANCIAL DEPRECIATION RATES IN COST STUDIES WILL INCREASE WHOLESALE RATES FOR UNES AND INTERCONNECTION.

The Commission should reject the CALLS ILEC proposal to provide only limited information regarding their depreciation accounts. Depreciation factors play a critical role in identifying the costs of universal services and of UNEs. When dealing with universal service cost studies, the Commission's practice is to use a uniform set of cost study parameters (including depreciation factors). If the Commission instead uses the range of factors that would result from the application of its waiver policy, it would find the universal service high cost loop support was based not on the cost of resources needed to provide that service, but rather on whether the ILEC had obtained a waiver of the depreciation requirements. Thus, it is critical that information on investment and retirements be provided to the Commission on a regular basis "to enable the Commission to continue to establish ranges (for depreciation parameters) for use in cost models."[15]

The same requirement applies to depreciation information used in UNE cost studies. These studies are conducted using forward-looking cost information, including economic depreciation.[16] The CALLS ILECs propose to provide only investment information, and on a much less frequent and regular basis, thus the participating ILECs would not provide the

[15] *Id.* ¶ 8.

information necessary to allow the Commission to regularly identify the appropriate range of depreciation parameters to be used in the cost studies. The Commission has the statutory obligation to affirm that the cost studies approved by the states for interconnection and UNEs are consistent with its rules. Thus, the Commission has a continuing requirement for information that will allow it to judge the reasonableness of depreciation parameters used in forward-looking cost studies.

Notably, the CALLS ILEC proposal is silent on whether a set of depreciation factors different from those used for regulatory reporting purposes can or should be used in cost studies. This silence may be interpreted to mean that the CALLS ILECs intend for a single set of depreciation factors be used for accounting and cost study purposes. Thus, their proposal would establish these higher financial depreciation rates for use by waiver participating ILECs in all cost studies—those for universal service and those for UNE rates and interconnection charges. Because UNE rates and interconnection charges are based on forward-looking costs, they would likely be unaffected by the existence or amortization of the depreciation reserve deficiency. However, the shorter lives and higher depreciation rates that result from this policy will necessarily be translated into higher TELRIC and TSLRIC estimates, leading to higher UNE rates and interconnection charges. These higher charges for UNEs and interconnection would hinder new competitive entry and the ability of existing competitors to remain in markets providing local telecommunication services, thus harming consumers who would not benefit from competitive services. The Commission should require participating ILECs to provide

[16] Implementing the Local Competition Provisions in the Telecommunications Act of 1966, *First Report and Order*, CC Docket 96-96, (rel. Aug. 8, 1996), ¶ 703.

sufficient information for accurate cost studies and avoid ILECs using the same high financial depreciation rates in these studies in order to avoid harmful impact on the competitive market.

IV. CONCLUSION

For the foregoing reasons, ALTS respectively urges the FCC to reject the CALLS ILEC depreciation waiver proposal. This proposal fails to meet the principles and guidelines established by the Commission to protect consumers and to avoid any negative impact on the fragile emerging competitive market for local telecommunication services.

Respectfully submitted,

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